

SPAIN

Fiscal Federalism in Spain: The Assignment of Taxation Powers to the Autonomous Communities¹

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1. INTRODUCTION

In this article, the status quo of fiscal federalism in Spain is described. The article begins by outlining the process followed by Spain in becoming the decentralized state it is today and how resources have been allocated, paying particular attention to the main political conflicts that this process has brought about. Secondly, the assignment of taxation powers is examined as this area has very recently been substantially reformed and is bound to become one of the main issues in relations between the central state (hereinafter: the state) and the autonomous communities (hereinafter: the Communities).

After being a centralized state for almost two hundred years, the devolution process did not prove to be easy. It was short, but politically very painful. As in other decentralized states, the way authority was devolved to the Communities had a very important affect on the allocation of resources. This is why it is relevant that a few words be dedicated to explain how this devolution process was carried out.

2. IS SPAIN A FEDERATION?: THE INTENTIONAL LACK OF DEFINITION OF THE FORM OF THE STATE IN THE CONSTITUTION OF 1978

The Spanish Constitution of 1978 (hereinafter: the Constitution) purposely omits any reference to the form of the state. That is, it does not describe it as centralized, federal or regional. After almost 40 years of being a very centralized government under Franco, consensus on this issue was difficult to obtain. The closest precedent for decentralization in Spain was established by the Constitution of 1931 – the Second Spanish Republic – and lasted only eight years (1931-1939). This model was intentionally not followed as its tragic ending in civil war did not make it a viable option. Until the Republic, Spain had been a centralized state for more than a century, which caused political tension.² The framers of the Constitution had before them one of the most difficult tasks that Spanish politicians could ever face: to resolve the “regional question” for good. It did, however, seem to be utopian. Probably the only aspect in which there was a generalized consensus was that something new had to be invented due to the failure of the Second Republic’s decentralization model.

The makers of the Constitution met this challenge by not defining the new system but by establishing a procedural framework instead. Thus, what the Constitution does is to

establish an “optional autonomy system”.³ It does not establish a model for the state, but refers to a procedure that can be followed. Thus, certain groups of provinces, provided that they have common historical, cultural and economic characteristics, have the right to decide if they want to become a Community.⁴ If they decide to do so, they then have to choose what matters they want to have jurisdiction over. In other words, this is autonomy *à la carte*.

The Constitution does not actually assign authority to Communities, but offers them the possibility of assuming jurisdiction over a group of matters listed in the Constitution.⁵

It does, however, reserve special functions for the state. Thus, for example, the state is in charge of “regulating the basic conditions to ensure the equality of all Spaniards in the exercise of their rights and the fulfilment of their obligations” (Art. 149(1)(1)), and is assigned exclusive authority for “coordination of the economy” (Art. 149(1)(13)).

Despite the existence of two lists of areas of authority in the Constitution – for Communities to choose from, and for the state to undertake – the design does not end there, as Art. 149(3) establishes a series of provisions that may change the actual distribution of authority. Thus, Communities may take on the authority not expressly assigned to the state by the Constitution and the state may take on the authority not taken on by Communities. If there is a conflict over which tier should be assigned a given matter, the norms of the state will prevail over the Communities. Lastly, Art. 149(3) establishes that the norms of the state will, at any rate, be supplementary to the Communities.

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2. See L. López Guerra, “Regions and Nationalities in Spain: the Autonomous Communities”, in Gisela Färber and Murray Forsyth (eds.), *The Regions – Factors of Integration or Disintegration in Europe?* (Baden-Baden: Nomos Verlagsgesellschaft, 1996), p. 145 et seq.; L. Moreno, “Asymmetry in Spain: Federalism in the Making?”, in R. Agranoff (ed.), *Accommodating Diversity: Asymmetry in Federal States* (Baden-Baden: Nomos Verlagsgesellschaft, 1999), p. 150 et seq.

3. The *principio dispositivo*; see I. de Otto y Pardo, *Derecho constitucional: sistema de fuentes* (Barcelona: Ariel, 1995), p. 256.

4. Art. 143(1) of the Constitution.

5. Arts. 148 and 149.

This last provision has been the object of much controversy, as the Constitutional Court recently radically changed its interpretation to avoid its use as an indirect means for the state to assume authority from Communities.⁶

Lastly, the Constitution allows the state to control Autonomous Communities in some cases (for example, Arts. 150(3), 153 or 155). In practice though, these provisions have never been invoked. Instead, the numerous conflicts have been resolved – or are in the process of being resolved – by agreement.

One relevant feature of the Constitutional design of the state is the strong role that the state plays in the distribution of authority. This can be explained by the coexistence of the principle of autonomy and the principle of unity. They are both expressed in Art. 2: “The Constitution is grounded on the indissoluble unity of the Spanish Nation ... and guarantees and recognizes the right to autonomy of its regions ...”. This apparent oxymoron has been the object of many Constitutional Court decisions, which confirm that it is within the unity of the state that autonomy can find its being.⁷

This process has given place to a form of state that, albeit still not quite defined, probably falls, together with the state forms of Belgium, Germany, Austria and the United Kingdom, into the category of a “decentralized state”. When we take a closer look at the broad scope of decentralization in Spain, however, and at the authority thus gained by the Communities over the past 20 years, it must be concluded that, whether we like it or not and this has become quite a controversial issue – Spain is, in practice, if not in origin, a federal state.⁸ At any rate, the “politically correct” term by which Spain is usually defined is that of a “State of Autonomies”.

3. THE DYNAMICS OF THE DEVOLUTION PROCESS: THE ASYMMETRIC MODEL AND THE NEED FOR BILATERAL AND MULTILATERAL AGREEMENTS

Probably the most outstanding feature of this process is the speed of its development. Between 1978 and 1983, all of the regions in Spain engaged in this process; the whole country is presently divided into 17 Communities.

The evolution of public expenditures clearly demonstrates this speed. In 1978 the state was in charge of 89% of public spending. Only 20 years later it is in charge of 51%, with the Communities in charge of almost 33%.⁹

Another important feature of this state model is its asymmetry. This asymmetry is both *de facto* and *de jure*¹⁰ and explains the key role played by political agreements. There are two reasons why the state model is asymmetric.

The first reason lies in the procedural framework established by the Constitution. It provides two special procedures for Communities to be formed. They differ from each other in that one allows for larger and faster autonomy, while the other entails a more limited and gradual assumption of authority. These are usually referred to as

the “fast” and “slow track” processes. Fast track Communities take on more authority, including health and education, which together represent about 80% of total authority that can be taken on by Communities. Eventually, slow trackers may increase their authority and gain access to the maximum level, provided that they follow the process established in Art. 148(2).

The original idea of the framers of the Constitution was that some Communities with self-government experiences should be given the opportunity to become fast trackers from the beginning, while the rest would have to start by being slow trackers. Hence the second transitory provision of the Constitution, which establishes fast access to autonomy for those Communities that approved self-government statutes in the past (i.e. during the Second Republic). These were to be Catalonia, the Basque Country and Galicia, which not only had brief access to autonomy in the years of the Republic but also had in common a more or less strong nationalist sentiment fuelled by the existence of different languages. In the end, however, seven Communities became fast trackers. Thus, in addition to the three mentioned above, Andalusia, Navarra, Valencia and the Canary Islands adopted the higher level of autonomy. The other ten Communities maintained a lower level of autonomy until 2002. The second main explanation for asymmetry lies in the recognition of “historic rights” for some regions. This has resulted in the Basque Country and Navarra having a much greater level of authority, especially in fiscal matters.

The first type of asymmetry can be categorized as *de facto* or *transitory*; it refers only to the initial process, but does not prevent all Communities from eventually gaining

6. This change in the case law took place in decisions 118/1996 and 61/1997; See E. García de Enterría and T. R. Fernández, *Curso de Derecho Administrativo (I)* (Madrid: Civitas, 1999), p. 345 et seq. A comprehensive analysis of the effects that such decisions have had upon the regulation of ceded taxes can be found in V. Ruiz Almendral, “La regla de la supletoriedad en relación con la atribución de competencias normativas a las Comunidades Autónomas sobre los impuestos cedidos”. Forthcoming in *Crónica Tributaria* 105 (2002).

7. This reasoning can be found in, inter alia, decisions 4/1981, 25/1981 and 37/1981. See also L. López Guerra (1996), note 2 and “The development of the Spanish “State of Autonomies” 1978-1992” in Jutta Kramer (ed.), *Föderalismus zwischen Integration und Sezession* (Baden-Baden: Nomos Verlagsgesellschaft, 1993), pp. 25-36.

8. Of course, even the term “federation” is not entirely uncontroversial. While for some it is necessary that the decentralization of powers derive directly from the Constitution in order to categorize a country as federal (S. H. Beer, “A Political Scientist’s View of Fiscal Federalism”, in W.E. Oates (ed.), *The Political Economy of Fiscal Federalism* (Toronto: Lexington Books, 1997), p. 22), others take the position that only those countries where subnational governments actually exercise their powers may fall into the said category (R. M. Bird, “A comparative perspective on federal finance” in K.G. Banting, D. M. Brown and T.J. Courchene (eds.), *The Future of Fiscal Federalism* (Kingston: School of Policy Studies, 1994), p. 295). Finally, it is so difficult to find two similar models of federations that the term itself must, in general, be used with the utmost care (R. L. Watts, “The value of comparative perspectives”, Id.).

9. For more detailed data on the decentralization of public expenditures in Spain see www.estadief.minhac.es (official web site of the Ministry of Finance).

10. See R. L. Watts, “The Theoretical and Practical Implications of Asymmetrical Federalism”, in R. Agranoff (ed.), *Accommodating Diversity: Asymmetry in Federal States*, note 2, p. 28 et seq., R. Agranoff, “Intergovernmental Relations and the Management of Asymmetry in Federal Spain”, Id., p. 96 et seq. and L. Moreno, Id., p. 151 et seq.

access to the same level of authority. The second type is a *de jure* asymmetry, of a much more controversial nature.¹¹

This explains why bilateral and multilateral agreements have played an important role in the assignment of authority. Bilateral agreements have been necessary to address the different autonomy aspirations of Communities. Moreover, in the case of the Basque country and Navarra, bilateral agreements were the only possible way to address the special status that “historic Communities” were granted by the Constitution. Multilateral agreements have coexisted with bilateral agreements and have served to greatly unify the authority of the different Communities.¹²

On the other hand, the rulings of the Constitutional Court have also played a role in the definition of authority. Taking into account that the vast majority of the areas of matters listed in the Constitution are actually shared between the state and the Communities, it is not hard to imagine that this has been a source of permanent conflict between both tiers of government. The Court, as the exclusive competent body to resolve such conflicts, has undertaken a very important task in the evolution of the “State of Autonomies”.¹³ It has also acknowledged the important role of agreements in the cooperative framework that is needed for the working of the state.¹⁴

As a result, leaving aside the case of the Basque Country and Navarra, the potentially asymmetric state model has become quite homogenous. As of 1 January 2002, two important matters that had still been unevenly assigned – health and education – are now in the hands of all Communities. Previously, this had been the main difference between fast and slow trackers. Now all have the same authority which, some hope, will provide the “State of Autonomies” with some stability.

Why it was done this way – as opposed to letting the process give rise to an authentic asymmetrical state – can also be explained by the political turmoil that followed the transition towards democracy, and which loomed large long after democracy was assured. There had been an authentic fear of asymmetry that may very well be unfounded.

4. THE ALLOCATION OF RESOURCES: TOWARDS FISCALLY RESPONSIBLE AUTONOMOUS COMMUNITIES?

4.1. In general

It is commonplace in fiscal federalism literature to refer to “vertical fiscal imbalance” as the situation that arises when one tier of government – usually the central state – has a greater power to obtain income than it actually needs for the exercise of its authority, while the other – subnational government tier – is in the opposite situation.¹⁵ This creates an imbalance that must be resolved in order to guarantee the required autonomy to the subnational governments. Otherwise, they will not be able to exercise their authority. The problem is easily understood and every party to the conflict – central state and subnational governments – usually agrees that it must be resolved and that the allocation of resources must be rebalanced. As usual,

the conflict arises in deciding which of the different solutions to use to solve the problem. Roughly, vertical imbalance can be resolved through transfers from the state or through a reassignment of taxation powers. As is well known, there are different advantages and disadvantages in choosing any of these solutions. In practice, a mix of them will be used, resulting in most subnational governments receiving financing both in the form of transfers and own taxes. It is also generally agreed that when subnational governments receive financing almost exclusively in the form of transfers, an incentive to overspend those moneys is created. The idea is simple and somewhat similar to the “moral hazard”¹⁶ problem: it is easier to spend monies when a) one does not shoulder the political burden of having to raise them (i.e. establishing or raising taxes) and b) there is no need to explain to voters/taxpayers what the relationship between the monies raised and monies spent is. In other words, the situation creates a lack of accountability that may not be advisable.

This debate has also taken place in Spain. It has been said that the low tax weight of tax revenues of Communities results in an alarming lack of fiscal responsibility that does not seem very consistent with the larger responsibility that

11. The difference between the Basque Country and Navarra’s finance systems lays not in legal spending powers but in taxation. In a recent agreement (20 February 2002), the state and the Basque country extended the taxation powers of this Community. In short, these Communities have extended powers to regulate the individual income tax, the net wealth tax, the inheritance and gift taxes, the transfer tax and stamp duty and the corporation tax. Some tax credits for small and medium-sized companies established by the Basque Country in respect of this last tax have created tension in the European Community in the past, as the European Commission, in its decision 93/337/CEE of 10 May 1993 (DO L 134, p. 25) stated that some of them violate the freedom of establishment (Art. 43 of the EC Treaty) and are also considered state aid (Art. 87 of the EC Treaty). A similar case is still pending before the Court (see the Opinions of the Advocate General, Mr Antonio Saggio, given 1 July 1999 in joined cases C-400/97, C-401/97 and C-402/97). For more information about such systems see L. López Guerra, “The Spanish Constitutional Court and Regional Autonomies in Spain”, in d’Athena (ed.), *Federalism and regionalism in Europe* (Napoli: Editoriale Scientifica, 1998); F. de la Hucha Celador, *Introducción al régimen jurídico de las Haciendas forales* (Madrid: Cívitas, 1995); See C. Monasterio Escudero and J. Suárez Pandiello, *Manual de Hacienda autonómica y local* (Barcelona: Ariel, 1998); Agranoff, note 2; and Moreno, note 2. A recent decision of the Spanish Constitutional Court (96/2002, 25 April) is particularly relevant. In *obiter dicta* the court seems to question whether the special taxing systems of the Basque Country and Navarra are constitutional. The court suggests that they may violate, *inter alia*, the equality principle. Recent court decisions can be found at www.tribunalconstitucional.es.

12. L. López Guerra, note 7, pp. 32-35; and R. Agranoff, “Intergovernmental Relations and the Management of Asymmetry in Federal Spain”, in R. Agranoff (ed.) *Accommodating Diversity: Asymmetry in Federal States* (Baden-Baden, Nomos Verlagsgesellschaft, 1999), pp. 107-112.

13. See L. López Guerra, note 11, and E. Aja and P. Pérez Tremps, “Tribunal Constitucional y organización territorial del Estado”, in E. Espín (ed.), *La justicia constitucional en el Estado democrático* (Valencia: Tirant lo blanch, 2000), pp. 141-179.

14. The Court points out the importance of agreements in fiscal matters in decision 181/1988.

15. Also referred to as the problem of “fiscal mismatch”, “fiscal gap” or “revenue gap”. See Oates, note 8, p. 16; R.W. Boadway and P.A.R. Hobson, *Intergovernmental Fiscal Relations in Canada* (Toronto: Canadian Tax Foundation, 1993), p. 28 et seq. and R.W. Boadway, “Recent Developments in the Economics of Federalism”, in Harvey Lazar (ed.), *Towards a New Mission Statement for Canadian Fiscal Federalism* (Kingston: Institute of Intergovernmental Relations: Queen’s University, 2000), p. 46 et seq.

16. Boadway (2000), note 15, p. 51.

Communities have in other areas.¹⁷ Significant examples are health and education. This debate has given place to substantial reforms of the Communities' financing systems. The main objective is to increase the Communities' powers to establish taxes and thus change the present situation while they are still seen by taxpayers as "fairy god-mothers" who offer services to citizens without asking for monies in exchange.

Here too, there are some important asymmetries in the system, e.g. the rules for the allocation of resources are very different in the case of the Basque Country and Navarra. They have, inter alia, much greater taxation powers than the rest of the Communities. These powers must be exercised in coordination with the central state's powers. The following section explains the rules for the allocation of resources in the remaining Communities, the "common system", thus leaving aside the above-mentioned special regimes.

4.2. Mechanisms for the allocation of resources: the role of political agreements

The role of political agreements has also been very relevant in the process of allocation of resources between the different tiers of government. This is quite a politicized issue in Spain that has been the cause of much stress between the state and some Communities (especially Catalonia and the Basque Country).

There are two major types of agreement, which are closely related: agreement between different political parties and negotiations between the state and the Communities (both bilateral and multilateral). The process usually unfolds as follows:

First, a multilateral agreement between the state and all the Communities is reached. This is done in the Finance and Tax Policy Council (FTPC), where the finance ministers of all Communities and the state are represented. Once an agreement has been approved, bilateral agreements with the state are signed. This is done in the "Mixed Commissions".¹⁸ In a parallel way, the main political parties usually negotiate the finance reforms.

This agreement system serves to give weight to the Communities' opinions on the allocation of resources. It has been broadly criticized, however, for its lack of transparency, as the agreements take place behind closed doors and the results are only partially made public. This may be referred to as "executive federalism". The result may be a restriction on democracy.¹⁹ It is often argued that most of this political discussion should take place in the senate, which, at least in theory, although not in practice, is the representative chamber of the Communities.²⁰

Another widely held criticism of the agreements is that they modify the rules for the allocation of resources, established in the Constitution and in the laws, to benefit those Communities in a better position to negotiate. These criticisms mainly arose after *Convergència i Unió* (CiU), the Catalan nationalist party, helped the two main national political parties, the *Partido Socialista Obrero Español* (PSOE) and the *Partido Popular* (PP), to have a sufficient majority to govern. In exchange, CiU wanted and obtained

a revision of the financing system of the Communities.²¹ The subsequent reforms in the system applied, however, to all Communities, not only Catalonia. Thus, this second criticism is, in the author's opinion, totally unfounded.

On the other hand, even the most critical agree that political agreements on the allocation of resources have played a very important role in guaranteeing Communities sufficient means for exercising their authority. Agreements are an essential part of a cooperative federalism system and cannot always be substituted by debate in parliament.²² This said, a reform of the senate is necessary as it would be the best way to reinforce these agreements.

4.3. The allocation of resources under the Constitution: the role of transfers and taxes in the financing of the Communities

In accordance with the recognition of autonomy, or stated more accurately, the recognition of the right to be autonomous, the Spanish Constitution grants formed Communities "financial autonomy for the development and execution of their authority". The Constitutional Court has interpreted this as their right to have sufficient means for carrying out their authority, as well as the right to manage those means without the state imposing undue conditions.²³

Apart from stating this principle of financial autonomy, the Constitution establishes a list of resources that will

17. See A. Rodríguez Bereijo, "Una reflexión sobre el sistema general de la financiación de las Comunidades Autónomas", *REDC* 15 (1985), p. 71; J.J. Zornoza Pérez, *Tributos propios y recargos de las Comunidades Autónomas* (Madrid: *Memoria de la Asociación Española de Derecho Financiero*, 1986/87, t. II, 1988), pp. 971 and 972; A. Castells, *Hacienda autonómica. Una perspectiva de federalismo fiscal* (Barcelona: Ariel, 1988), p. 129 et seq. and "The role of intergovernmental finance in achieving diversity and cohesion: the case of Spain", *Document de treball* 2000/2, Institut d'Economia de Barcelona, p. 14 et seq.; J. Solé-Vilanova, "Regional and Local Finance in Spain: Is Fiscal Responsibility the Missing Element?", in R.J. Bennett (ed.), *Decentralization, Local Governments and Markets* (Oxford: Clarendon Press, 1990), p. 350; and J. Ramallo Massanet, "La asimetría del poder tributario y del poder de gasto de las Comunidades Autónomas", *Revista Española de Derecho Constitucional* 39 (1993).

18. A comprehensive analysis of such agreements, as well as their evolution, can be found in J. Ramallo Massanet and J.J. Zornoza Pérez, "El Consejo de Política Fiscal y Financiera y las Comisiones mixtas en la financiación de las Comunidades Autónomas", *Papeles de Economía Española* 83 (2000).

19. K. Wiltshire, "Working with intergovernmental agreements – the Canadian and Australian experience", 23 *Canadian Public Administration* 3 (1980), p. 369.

20. There are two main causes for this. First, the fact that most senators are elected by universal suffrage from provincial voting districts, while only a minority (46 out of 253) are appointed by the parliaments of the Communities. Thus, according to Art. 69 of the Constitution and Art. 165 of the Law of General Elections (Organic Law 5/1985, 19 June), there are four senators per province that are elected directly by citizens. Every Community may then choose one senator, plus one more for every million inhabitants in the Community. See López Guerra, note 12, p. 27. Second, the senate has very limited powers to make state laws (i.e. no veto rights).

21. The CiU's support of the PSOE was the origin of the sharing of a percentage of the income tax for some Communities, which was agreed to in the FTPC (agreement of 10 October 1993). The CiU's support for the PP was equally the origin of the 1997 reform (agreement of the FTPC of 23 September 1996).

22. See Wiltshire, note 19, p. 355 et seq.; M.P. Brown, "Responsiveness versus accountability in collaborative federalism: the Canadian experience", 26 *Canadian Public Administration* 4 (1983), p. 631 et seq.

23. Decision 13/1992 contains a comprehensive summary of the case law of the court on this matter.

constitute the Communities' income. This list includes almost all possible kinds of resources. Thus, they may obtain revenues from ceded taxes, surtaxes on existing state taxes, their own taxes and public debt and transfers (Art. 157(1)). The Constitution does not do much more, however, than list these resources. In the same section (157.3), it allows the state to approve a law regulating how these resources will be distributed among the Communities and, more importantly, the limits on the exercise of the Communities' financial powers over the resources.

This implies that the state is given the power to quite broadly both limit and control the financial autonomy of the Communities. To some, this is inconsistent with the recognition of the right to autonomy granted to the Communities. The state has made use of this possibility and approved a set of laws that greatly limit the financial autonomy of Communities.²⁴

A good example of these limits are those established on the creation of new taxes by Communities discussed in the next section. Although it is not always clear whether it is the limitations on establishing new taxes or the unwillingness to withstand the political consequences of increasing the tax burden that has deterred Communities from creating new taxes, the existence of such limits underlines the importance of intergovernmental transfers in Spain and explains the substantial imbalance between the Communities' autonomy over spending – which has been strongly supported by the Constitutional Court – and their limited power to raise their own revenues.

Therefore, since the beginning of the "State of Autonomies", transfers have played a far more important role than own taxes, which has resulted in the Communities' financial dependence on the state, as can be seen in the figure below.

If we take into account that ceded taxes, as we will later see, are closer to being a transfer than a tax revenue, the

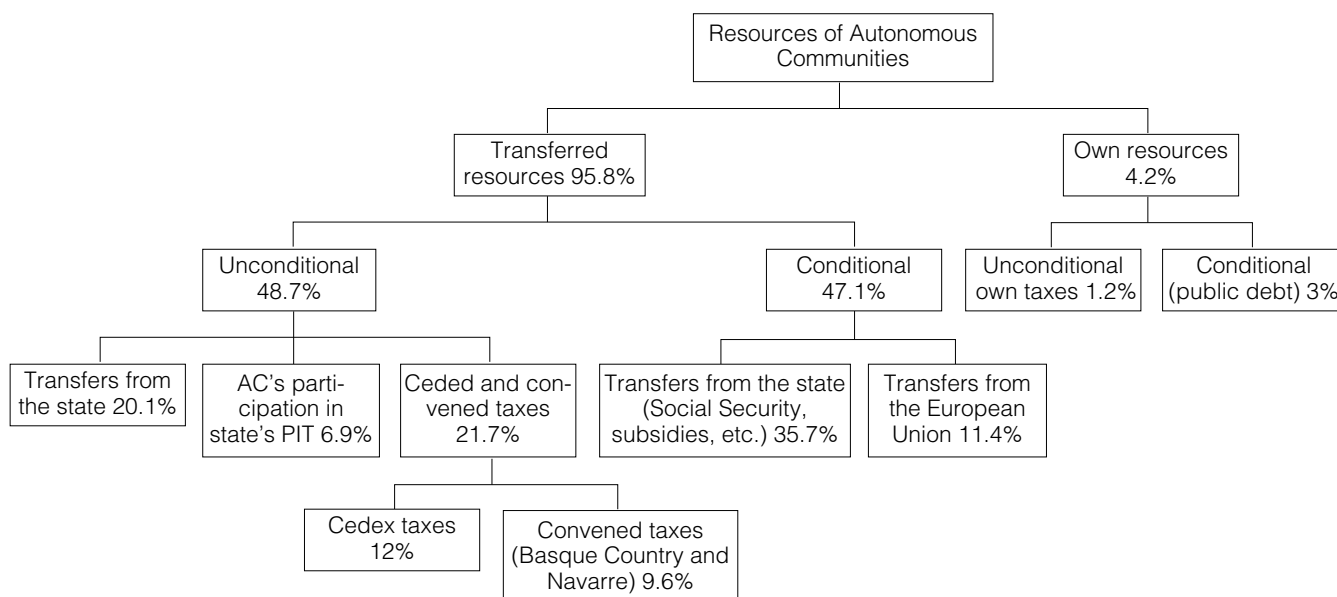
conclusion is clear: Communities' own resources account for only 4.2% of their total income. Meanwhile, as we have seen, they are in charge of almost one third of public expenditures.

Since the early years of the State of Autonomies, the allocation of resources has been consistent with the devolution of authority to the Communities in that, since the first matters were devolved to them, stress has been put on the sufficiency of the Communities' financing, which has been done mainly through unconditional transfers from the state to the Communities.

These transfers were traditionally supposed to be based upon need. That is, the cost of the devolved authority would be calculated and a given amount would then be transferred to the Communities. In reality, the cost was never actually calculated but rather negotiated in bilateral commissions (between the state and each Community) that would meet behind closed doors and agree on a certain quantity. This was done because the existing accounting systems of the state were inadequate for such calculations; thus, the actual cost of the transferred services was never actually determined.²⁵ This continuous negotiation was also the object of sharp criticism from different sectors. Apart from the argument that it was undemocratic, it was deemed to create inequalities from a financial per-

24. Recently, the state passed a law to curb the deficit of Communities, and thus comply with EU requirements. This is the *General Budget Stability Law* (Law 18/2001 of 12 December, *General de Estabilidad Presupuestaria*); it imposes new limits on the creation of public debt by Communities. This Law has been challenged before the Constitutional Court by the Socialist Party.

25. See Generalidad de Cataluña, *Libro blanco del gobierno de la generalidad de Cataluña sobre la financiación autonómica* (Departamento de Economía y Finanzas, 1985), p. 35 et seq.; Castells (1988), note 17, p. 138 et seq.; C. Monasterio Eescudero and J. Suárez Pandiello, *Financiación autonómica y correspondencia fiscal en España* (Bilbao: Fundación BBV, 1993), p. 17 et seq.; and J.J. Zornoza Pérez, note 17 and "Los recursos de las Comunidades Autónomas", *Cuadernos y Debates*, No. 8 (Madrid: Centro de Estudios Constitucionales, 1996).



Source: The author and Ministerio de Hacienda, *Secretaría de Estado de Presupuestos y Gastos, Informe sobre la financiación de las Comunidades y Ciudades Autónomas. Ejercicio 1998* (Madrid, 201), p. 19.

spective as, eventually, those Communities whose bargaining position was weaker would get less monies to exercise their authority.

Conditional transfers have a large relative weight in the financing of Communities. As in many other decentralized states, their mere existence has given rise to many controversies in the past. According to the Constitutional Court's rulings, when the state transfers monies to the Communities, these transfers must be unconditional if their object is to pay for classes of matters that fall under the authority of the Communities. Otherwise, according to the Court, the spending power of the state would be intrusive, serving indirectly as a way of controlling the Communities' activities.²⁶ Although this general principle has been stated in the case law, in practice this has been a continuous source of stress between the Communities and the state. The main claim of the Communities has been that the state puts conditions on the transfers of monies that go far beyond its authority, thus intruding into the Communities' powers.

This financial dependence of Communities was not a problem in the early years of the Spanish government. Back then, the Communities were regarded with a certain distrust and some of their attempts to establish new taxes were severely rejected by voters.²⁷ This rejection can also be explained by the major tax reform that took place at the end of the 1970s, which brought about a great increase in the tax burden necessary to help the transformation of Spain into a welfare state.

As the Communities gained more authority, their financial needs grew substantially and a greater expansion of the transfer system was needed. Thus, the more autonomous Communities, that is, those that followed the "fast track" and gained greater authority, ended up being the most financially dependent. Debates about the Communities' fiscal responsibility became one of the main issues in the relationship between the state and the Communities. By the end of the 1980s, certain Communities were ready to play a more active role in taxation policy. At this time, some Communities (such as Galicia and Catalonia)²⁸ introduced proposals to obtain a greater part of their resources from taxes, as opposed to getting it from transfers. Moreover, once the "State of Autonomies" had become a reality, the idea that the Communities should have more of a say in taxation matters became common place. One of the main problems was the limited scope of the Communities' taxation powers, as is discussed in the next section.

4.4. The limited powers of the Communities to establish new taxes

Although the Constitution bestows taxation powers upon the Communities (Arts. 133 and 157), the Autonomous Communities Finance Act imposes severe limits on the creation of new taxes. The most important limitation is the prohibition of double taxation, which prevents Community taxes from being similar to taxes created by the central state and the municipalities. As these two bodies had already established taxes on most of the imaginable sources of revenues, little tax room was left for Communities.²⁹ Moreover, the Constitutional Court recently broadly

interpreted these limits, making it almost impossible for Communities to invent new taxes.³⁰ The existing tax room was traditionally occupied by the state and the municipalities, and this did not change when the Communities became a reality.

Therefore, despite Constitutional provisions that guarantee Communities both the power to establish taxes and financial autonomy (Art. 156(1)), the limits established by the central state have led to a system whereby taxation powers remain mostly in the state's hands.

In order to avoid the limitation on double taxation and at the same time make taxes more "attractive" to taxpayers, in the late 1980s Communities began to establish taxes that differed greatly from the traditional ones. Their objective was not only to obtain monies from taxpayers but also to serve some social objectives such as the protection of the environment. These are the "green taxes". At present, most Community taxes apparently fall under this fairly new category of taxes. In taking a closer look at the structure of many of these taxes, however, it is apparent that they are just regular run-of-the-mill taxes dressed-up as "green" to serve the two objectives mentioned above. The Constitutional Court recently declared one of these taxes void.³¹ Although the general reasoning in the decision is quite defensible, one of the reasons the tax was found to be void was that – according to the Court – it was not a real green tax.

Generally, the establishment of new taxes is not a very good option for Communities. On the one hand, most of the Communities' taxes are very costly to administer and do not generate much income, as can be seen in the figure on the preceding page. On the other hand, almost every time a Community establishes a new tax, the state challenges it before the Constitutional Court.³²

This reality has inspired the reforms of 1997 and 2002, which are very likely the most important reforms in the system of allocation of resources between the state and the Communities since the "State of Autonomies" was born.

26. Decision 13/1992.

27. In this respect, what happened to the Community of Madrid is quite significant. In the early 1980s it decided to establish a surtax on the state's individual income tax of about 3%. Many argued that such a surtax was unconstitutional and it was challenged before the Constitutional Court. In decision 150/1990 the Court declared it perfectly valid. The law never actually entered into force, however, and the government that had established it (PSOE) lost the next election to the PP.

28. Generalidad de Cataluña, note 25.

29. See Zornoza Pérez, notes 17 and 25.

30. Decision 289/2000.

31. Decision 289/2000 declared void the tax on facilities that affect the environment, established by the Balearic Community.

32. Recently, Catalonia established a tax on large commercial areas (*Impuesto sobre grandes establecimientos comerciales*) by Law 16/2000 of 29 December. No sooner had the law been approved by Catalonia's parliament than it was challenged by the state before the Constitutional Court on the grounds that it is equivalent to some of the municipality taxes (the property tax and the economic activities tax).

4.5. The attempt to reassign taxation powers in the "State of Autonomies": The 1997 and 2002 ceded taxes reforms

Until 1997, the main principle for financing the Communities had been the principle of sufficient means. As a result of the 1997 reforms, the goal is to have Communities that are more involved in the establishment of taxes and are thus more directly accountable to the taxpayers for the monies they spend. This was accomplished through a reassignment of taxation powers that took place between 1997 and 2002. As with other reforms, bilateral and multi-lateral agreements have played a major role in the reassignment. As a result of these reforms, the Communities still rely mainly on transfers but their taxation powers have substantially increased, which is bound to decrease the fiscal dependence of Communities in the future.

The reforms consist basically of the sharing of some tax room that until then had been occupied only by the state. This is done through a type of resource called a "ceded tax". Note that the term "ceded" is not quite accurate, as it was not the tax but rather its yield that was ceded to Communities.

Thus, until 1997, ceded taxes were state taxes whose yield was granted to Communities according to the taxes paid within their territory. Due to powers delegated by the state, Communities had also taken on responsibility for administering these taxes. Ceded taxes were a kind of transfer, pursuant to which some of the taxes owned and entirely regulated by the state accrued to and were administered by the Communities. This differs from a transfer in that Communities may receive a sort of "bonus" in some cases. Thus, if the actual yield of the tax is superior to what had been forecasted by the state, the Communities receive the difference. If it is less, the Community receives the initial forecasted quantity. This increase in the yield may or may not, however, be a consequence of a better administration; for example, it may be due to mere economic reasons. Therefore, this "bonus" only partially serves as an incentive for Communities to more efficiently administer ceded taxes.³³ On the other hand, the Communities' decision-making powers over these kinds of taxes are almost non-existent. It may thus be concluded that ceded taxes are a type of resource that is conceptually closer to a transfer.

In order to give the Communities more tax room, a reform was enacted giving ceded taxes quite a different meaning than they had had until then. The power to regulate some aspects of these taxes – mainly tax brackets, tax rates and some tax credits – was conferred on the Communities. What until 1997 had been a form of transfer became a form of tax sharing.³⁴

The powers that Communities have over the various ceded taxes differ. As a result, depending on the tax, the yield will totally or partially accrue to the Communities, who may or may not take on legislative powers and may or may not be in charge of administering the tax.

CEDED TAXES AS OF 1 JANUARY 1997

Ceded taxes	Yield to Communities (%)	Administration	Legislative powers that Communities may take on
individual income tax	33	state	<ul style="list-style-type: none"> – tax rates (must have same number of tax brackets as the state tax) – tax credits (under certain conditions)
net wealth tax	100	Communities	<ul style="list-style-type: none"> – tax rates (must have same number of tax brackets as the state tax) – minimal deduction
inheritance and gift taxes	100	Communities	<ul style="list-style-type: none"> – reductions in the taxable income – tax rates
transfer tax and stamp duty	100	Communities	<ul style="list-style-type: none"> – tax rates
gambling taxes	100	Communities	<ul style="list-style-type: none"> – exemptions – taxable base – tax rates – tax credits – tax administration regulations

The Communities are given the option to choose whether they want to exercise their regulatory powers. If they fail to do so or decide not to exercise such powers, the state regulates every aspect of the Community. If a Community decides to exercise regulatory powers over any ceded tax, it may do so by approving legislation that will then take the place of the state law in those areas where the Community can legislate.

For instance, in the case of the net wealth tax (where Communities may establish whatever tax rates they choose), state legislation on tax rates will be applied to residents in those Communities that decide not to establish their own tax rates. Communities may also decide not to make use of the conferred powers, in which case the state legislation will apply.

33. The administration of ceded taxes by Communities is a major problem that has not, in the author's opinion, received enough attention by politicians and scholars. As the excellent study of A. García Martínez shows, *La Gestión de los tributos autonómicos* (Madrid: Cívitas, 2000), this administration is, generally speaking, quite inefficient. This is due to several reasons that the author thoroughly explains in this work. In short, it is due to the amazing lack of cooperation between the Communities and the state in this task.

34. See in respect of this reform: J.J. Zornoza Pérez, "Corresponsabilidad fiscal y financiación de las Comunidades Autónomas: el modelo para el quinquenio 1997-2001", in Jiménez-Blanco and Martínez Simancas (eds.), *El Estado de las Autonomías* (Madrid: Ceura, 1997); J. Ruiz-Huerta and J. López Laborda, "Catorce preguntas sobre el nuevo sistema de financiación autonómica", in *Informe Comunidades Autónomas 1996* (Barcelona: Instituto de Derecho Público, 1997; and Castells (2000)(b), note 17.

The way that this option has been structured – and the fact that the state still guarantees Communities lump-sum grants allocated on the basis of historical shares in state transfers – serves to create a strong disincentive for Communities to use their new taxation powers. Proof of this disincentive is the fact that since 1997, the Communities

have used their powers mainly to create new fiscal benefits.

There is a considerable number of examples. With respect to individual income tax, there are, among others, the following tax credits:

Communities	Tax credits in respect of individual income tax – IRPF (*)
Andalucia (**)	
Aragon	– “baby bonus”: birth or adoption of child
Asturias	has not regulated any aspect of the IRPF
Balearic Islands	– taxpayer older than 65 – disabled taxpayer or ascendants or descendants – acquisition of house by taxpayers younger than 32 – kindergarten for taxpayers’ descendants between the ages of 3 and 6 – descendant attending university outside the island of residence
Canary Islands	has not regulated any aspect of the IRPF
Cantabria	has not regulated any aspect of the IRPF
Castilla-La Mancha (**)	
Castilla and Leon	– taxpayer with more than three children (if disabled children, increase of the quantity) – “baby bonus”: birth or adoption of child – investment in property categorized as historic or artistic
Catalonia	– “baby bonus”: birth or adoption of child – donations to funds the object of which is the protection and enhancement of the use of the Catalan language.
Extremadura (**)	
Galicia	– “baby bonus”: birth or adoption of child – taxpayer with more than three children (if disabled children, the quantity increases) – payment to another person for taking care of a taxpayer’s child under three
Madrid	– “baby bonus”: birth or adoption of child – donations to certain cultural entities – ascendants older than 65 living with taxpayer
Murcia	– acquisition of house by taxpayers younger than 30 – donations to certain cultural entities
Rioja	– “baby bonus”: birth or adoption of child – acquisition of house by taxpayers younger than 32 – acquisition of a second house in certain small villages of La Rioja that are particularly underpopulated
Valencia	– “baby bonus”: birth or adoption of child – taxpayer older than 65 and disabled – acquisition of first house by taxpayers younger than 35 – donations to certain cultural entities, the object of which is the protection of the environment – spouse unemployed

(*) According to Laws 7/2001 and 21/2001, the individual income tax Communities may: 1) establish tax rates with the same progressivity as the state’s and 2) establish tax credits for personal and family circumstances and for investments not related to professional or commercial economic activities.

(**) These three Communities did not accept the finance model for 1997/2001 with the consequence, inter alia, that they did not have regulatory powers on ceded taxes. As of 1 January 2002 all Communities have accepted the model and all have, therefore, such powers.

Please note that the above description of tax credits is only a basic summary. There are extensive regulations on the different tax credits in each Community. Thus, the conditions that need to be met to benefit from them vary substantially depending on the Community (i.e. different taxable base thresholds).³⁵ Also, the credits themselves vary substantially from each other. For example, with respect to

the “baby bonuses”, different weights are given by each Community as to the problem of birth rates:³⁶

35. Further information about ceded taxes can be found at www.aeat.es.

36. Note that Spain has one of the lowest birth rates in the world.

BABY BONUSES IN AUTONOMOUS COMMUNITIES

Autonomous Community	Amount of tax credit for birth or adoption of child
Aragon	third and subsequent child: EUR 500
Castilla and Leon	first child: EUR 75.13 second child: EUR 150.24 third and subsequent child: EUR 360.61
Catalonia	first and subsequent child: EUR 300
Galicia	first and subsequent child: EUR 240
Rioja	second child: EUR 150 third and subsequent child: EUR 180
Madrid	first and subsequent child: EUR 280
Valencia	third and subsequent child: EUR 150.25

VAT	35	state	none
excise	40	state	none
tax on wine	40	state	none
tax on electricity	100	state	none
tax on vehicles	100	Communities	– tax rates (under certain conditions and limits)
special tax on gas	100	Communities	– tax rates (under certain conditions and limits) – tax administration regulations

In July 2001 the Communities and the state agreed to broaden the scope of these ceded taxes. As a result, the Communities' legislative powers over some of these taxes are now greater and new taxes have been ceded to them. The new powers over the ceded taxes vary so widely, depending on the tax, that in some cases the ceded tax operates as a mere transfer (as in Value Added Tax) and in others, the broad scope of the powers granted makes the tax very similar to an autonomous tax (as in gambling taxes).

CEDED TAXES AS OF 1 JANUARY 2002

Ceded taxes	Yield to Communities (%)	Administration	Legislative powers that Communities may take on
individual income tax	33	state	– tax rates (must have same number of tax brackets as the state tax) – tax credits (under certain conditions)
net wealth tax	100	Communities	– tax rates – minimal deduction – tax credits
inheritance and gift taxes	100	Communities	– reductions on taxable income – tax rates – deductions and tax credits – tax administration regulations
transfer tax and stamp duty	100	Communities	– tax rates – tax credits – tax administration regulations
gambling taxes	100	Communities	– exemptions – taxable base – tax rates – tax credits – tax administration regulations

V. SOME BASIC CONCLUSIONS

The decentralization process in Spain has occurred rather quickly and, generally speaking, has been quite successful. Altogether, authority has been devolved to Communities in an orderly fashion and this new tier of government has been well accepted by citizens. Nonetheless, some issues remain unresolved. Thus, while the agreements are a necessary part of the cooperative federalism model that exists in Spain, the senate should also play a role in the process. This will not be possible unless there is a substantial reform of this institution. This reform is now more necessary than ever, as only an adequate representative chamber can guarantee that Communities will have a say in some of the EU policies that affect them. Moreover, as important as the opinions of the Constitutional Court may have been in the clarification of the devolution process in the past, it is imperative for these conflicts to be discussed and resolved in parliament, thus decreasing what has come to be known as a "judicialization" of the "State of Autonomies".

As to the allocation of resources, an important reassignment of taxation powers has taken place and Communities now have more room than ever before to design their own taxation policies. However, they still seem to prefer to rely mainly on state transfers. Insofar as one of the purposes of the reforms was to increase the Communities' fiscal responsibility and make them more accountable to taxpayers for the monies they spend, they may have failed. It remains to be seen whether the latest increase of Community taxation powers will help to change this situation. It is likely that it will not, since the incentive problems described remain largely the same in the laws putting the new agreements into practice.